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IN THE

Supreme Court of the United States

OCTOBER TERM 1955

In the Matter of Proceedings for an Arrangement Under Chapter XI of the Bankruptcy Act

of

GENERAL STORES CORPORATION,
Debtor-Petitioner,

v.

MAX SHILENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE and WAGE CLAIMANTS,
Respondents.

MEMORANDUM ON BEHALF OF THE CREDITORS COMMITTEE

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MEMORANDUM ON BEHALF OF THE CREDITORS COMMITTEE

The Creditors Committee joins with the Debtor-Petitioner, General Stores Corporation, in praying that a Writ of Certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Second Circuit dated April 14, 1955, which by a divided court affirmed the judgment of the United States District Court for the Southern District of New York entered on March 7, 1955. The decision of the Court below is that Chapter XI of the Bankruptcy Act is not available to corporations whose stock is publicly held.

Statement

On October 18, 1954, General Stores Corporation filed a petition in the District Court for the Southern District of New York, in accordance with the provisions of Section 322* of Chapter XI of the Bankruptcy Act, in which it proposed an arrangement of its general unsecured obligations (R. 13a). Under the plan, such creditors would receive 100% of their claim, 20% upon confirmation of the plan and 20% annually thereafter. Statutory priority creditors would be paid in full (R. 14a).

Prior to the filing of the Chapter XI petition, General Stores Corporation conducted a chain of retail cigar stores (R. 42a). It also purchased and still owns the entire capital stock of Stineway Drug Company and Ford Hopkins Company, which companies operate drug-restaurant chains in Chicago and mid-western States (R. 37a). All of the capital stock of these subsidiaries is held by the seller under a trust agreement, as security for the payment of the balance of the purchase price, approximately $2,000,000 (R. 43a, 46a).

The debtor's capital structure consists of a little over 2,000,000 shares of $1.00 par common stock held by approximately 7,000 stockholders and listed on the American Stock Exchange (R. 30a). It has only one class of stockholders (R. 43a) and two classes of creditors, namely, priority creditors (in the main, for wages and taxes) and general unsecured creditors (in the main, merchandise creditors, former employees and landlords on rejected leases) (R. 40a, 42a).

During the administration of these proceedings the debtor rejected all of its existing executory lease agreements covering its retail cigar stores and converted into cash all of its merchandise inventory, fixtures and equipment, so

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*11 U. S. C. 722; 52 Stat. 907

that the assets of the debtor now consist solely of (1) cash on hand and (2) all of the capital stock of the aforementioned subsidiaries (R. 54a).

In the course of these proceedings it became apparent that the assets of the debtor would not permit the payment to unsecured creditors of the full amount of their claims. The debtor proposed to the Creditors Committee to pay the equivalent of 40% of the unsecured creditors claims in full satisfaction thereof, payable 10% in cash and 30% in shares of the debtor's common stock. This proposal has received the approval of a majority of the official creditors committee.*

Reasons for Granting the Writ

There are several substantial reasons for the issuance of a Writ of Certiorari to review the judgment of the Circuit Court of Appeals.

The Court below has declared that a debtor whose stock is listed on an exchange and publicly held may not compose its unsecured obligations unless it resorts to the elaborate investigatory procedures involved in a reorganization pursuant to Chapter X of the Bankruptcy Act. This concept is unwarranted under the provisions of the Bankruptcy Act and the previous decisions of this and other courts and is the result of a misinterpretation of the holding of this Court in the *U. S. Realty* case.†

(1) In the *U. S. Realty* case the debtor had assets of $7,076,515 and liabilities of $5,051,416, of which only $74,916 was current. This indebtedness included two series of

*The statement of the case is not a complete exposition of the proceedings below but has been abbreviated pursuant to Rule 40, subdivision 3 of the Revised Rules of Court.

†*Securities and Exchange Commission v. U. S. Realty & Improvement Co.*, 310 U. S. 434.

publicly held debentures aggregating $2,339,000, which were secured by corporate stock, and a $3,000,000 note secured by a first mortgage held by the debtor. The debtor was also liable as a guarantor of mortgage certificates in the sum of $3,710,500 issued by its wholly-owned subsidiary and held by some 900 holders. It was this latter obligation which the debtor sought to modify by a plan pursuant to Chapter XI.

This Court, limiting its decision to the particular situation presented,* held that the question whether any "fair and equitable" arrangement could be effected without readjustment of the capital structure of the debtor could best be answered in a Chapter X proceeding.

In the first instance it is noted that the debt structure of the Debtor-Petitioner in the present case is dissimilar to that of the debtor in the *U. S. Realty* case. The present debtor does not have any debentures, bonds, mortgages, notes or any like obligations in the hands of the general public. It has but one class of stockholders. Indeed, the entire corporate structure of the Debtor-Petitioner is one of complete simplicity.

Secondly, the decision in the *U. S. Realty* case is based upon the law as it then existed that any plan of arrangement under Chapter XI had to meet the "fair and equitable" standard. At 310 U. S. 434, 452, the Court wrote:

> "'Fair and equitable', taken from § 77B and made the condition of confirmation under both Chapter X or Chapter XI are 'words of art' having a well understood meaning in reorganizations in equitable receiverships and under § 77B which is incorporated in the structure of both Chapters X and XI. See Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 115 et seq., 60 S. Ct. 1, 7, 84 L. Ed. 110. The phrase signifies that the plan or arrangement must conform to the rule of Northern Pacific Ry. Co. v. Boyd, 228 U. S.

* *Securities & Exchange Commission v. U. S. Realty & Improvement Co.*, 310 U. S. 434, 454 (1940).

482, 33 S. Ct. 554, 57 L. Ed. 931, which established the principle which we recently applied in the Los Angeles case, *that in any plan of corporate reorganization unsecured creditors are entitled to priority over stockholders to the full extent of their debts and that any scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of stockholders is inadmissible.*" (Emphasis ours.)

In 1952 Congress amended Section 366 of the Bankruptcy Act* and eliminated the requirement that a plan of arrangement be "fair and equitable". The House of Representatives, in its report accompanying amendatory Bill S2234 (House Report No. 2320, 82nd Cong., 2nd Sess., in substance being the same as Senate Report No. 1395), said (2 U. S. Cong. & Adm. News '52, 1981):

"These sections (Secs. 366, 472 and 656a) presently require a finding that a proposed plan under chapters XI, XII, and XIII shall be 'fair and equitable'. In fact, however, the fair and equitable rule, as interpreted in Northern Pacific Railway Co. v. Boyd, 228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931 (1913) and Case v. Los Angeles Lumber Products Co. Ltd., 308 U. S. 106, 41 Am. B. R. (N. S.) 110, 60 S. Ct. 1, 84 L. Ed. 110 (1939), cannot realistically be applied in a chapter XI, XII, or XIII proceeding.

"Chapter XI has replaced the old composition procedure under former section 12 of the Bankruptcy Act, where the fair and equitable rule did not apply. Nor is it practicable or realistic to apply the rule in a proceeding under chapter XI, XII, or XIII.

"The proposed amendment is designed to remove the fair and equitable provision, and by the paragraph added to each of the amended sections † it is made

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*11 U. S. C. 766; 66 Stat. 433.

†The following paragraph was added to Section 366: "Confirmation of an arrangement shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interests of its stockholders or members will be preserved under the arrangement."

clear that the rule of the Boyd and Los Angeles cases shall not be operative under those three chapters." (Interpolation ours.)

This renunciation by Congress of the rule laid down in the *Boyd* and *Los Angeles* cases, which prompted the majority decision in the *U. S. Realty* case, would appear to give greater credence to the minority decision. Judge Roberts in his dissent (concurred in by the then Chief Justice Hughes and Mr. Justice McReynolds) said (p. 464):

> "The Act will be searched in vain for any hint of such a distinction (the contention of S.E.C. that Chapter X applies to corporations whose securities are held by the public, while Chapter XI applies to close corporations). Small corporations are permitted to avail themselves of Chapter X if stockholders' or secured creditors' rights are to be affected; large corporations, under the very letter of Chapter XI, may avail themselves of its provisions *if all they desire to do is to extend or accommodate their unsecured indebtedness.* The smallest corporation cannot come in under Chapter XI if it desires what has been traditionally known as a reorganization. *The largest corporation may proceed under Chapter XI if it does not desire a reorganization.*" (Interpolation and emphasis ours.)

(2) The *Mecca Temple* case* is also relied upon by the Court below as determinative of the issues involved in the present case. In that case the debtor, a membership corporation, was obligated in the sum of $1,200,000 principal and interest as a result of a bond issue in the principal amount of $763,000. It proposed to pay each unsecured bondholder, 1,834 in number and located throughout the country and not necessarily all members of the debtor, 10% of the principal amount of his outstanding bonds in installments of 1% per year for ten years, without interest. At 142 F. 2d 869, 871, the Court wrote:

Mecca Temple of Ancient Arabic Order of Nobles of Mystic Shrine v. Darrock, 2 Cir., 142 F. 2d 869, certiorari denied 323 U. S. 784

"Of course, there still is no well-defined answer in the borderline cases to the question as to whether a particular type corporation should be permitted to proceed under Chapter XI; but especially persuasive here is the nature of the debtor's financial structure, which is such that if a reorganization under Chapter X is not required, the interests of an objecting creditor like appellant are not likely to be adequately protected. We have seen that the annual income of the debtor is well in excess of $50,000, while disbursements total less than $15,000 (a sum which appellant urges could easily be substantially reduced); and yet there is no explanation of the use to which the balance of the receipts is being put. Some explanation is surely due the creditors before they should be obliged to accept 10 cents on the dollar for their principal and nothing at all for their long overdue interest. Should the plan of arrangement proposed in the petition be confirmed, the debtor would be able to liquidate its indebtedness for $7,630 per year for ten years—a result palpably unjust to the unsecured creditors of a corporation whose income appears to exceed its authorized expenditures by nearly $40,000 yearly. These facts by themselves suggest that the plan merits condemnation under Bankruptcy Act, § 366(2), which states that the court shall confirm an arrangement only if it is convinced that 'it is for the best interests of the creditors'."

In addition to finding the proposed plan "palpably unjust", the Court also followed the *U. S. Realty* case with respect to the "fair and equitable" rule and found a further reason to direct a transfer to Chapter X by applying the rule of the *Boyd* case. There has been nothing to indicate that the proposed arrangement in the present case is unjust or inequitable. The *Mecca Temple* case is, therefore, inapplicable on its facts to the present case and, in any event, its value as a precedent is, along with the *U. S. Realty* case, seriously affected by the 1952 amendment to the Bankruptcy Act, which deleted the "fair and equitable" requirement.

(3) In the *Transvision* case*, a different panel of the Court below, in a substantially similar situation, affirmed an order of the District Court which denied an application by the Securities and Exchange Commission for a dismissal of the Chapter XI proceeding and its conversion into a Chapter X proceeding. At 217 F. 2d 243, 247, Judge Medina, speaking for the Court, wrote:

> "The SEC has adduced no information which would tend to indicate that the plan is likely to fail, but has, at most, indicated that there may be some basis for suspecting possible improprieties in past management. Certainly, so ephemeral a suspicion is not an adequate basis upon which to overturn a plan which the District Court, on the facts before it at this time, appears to believe may ultimately be found feasible, and one which, necessarily, would have to be acceptable to at least a majority of the unsecured creditors before being approved."

In the present case there has not been even the slightest intimation of any wrongdoing which would require the protective features of a Chapter X proceeding.† Moreover, as in the *Transvision* case, the proposed arrangement "may well enure to the ultimate advantage of the petitioner and its stockholders" (217 F. 2d 243, 247). The failure of the Court below to follow the *Transvision* case further confused the situation with respect to the circumstances under which a corporate debtor may resort to Chapter XI and is still another reason for the granting of a writ of certiorari in the present case.

(4) It is important to point out that under Section 366 of the Bankruptcy Act,‡ as amended in 1952, the funda-

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* *In re Transvision, Inc.*, 217 F. 2d 243, certiorari denied 348 U. S. 952.

† Indeed, as stated by Judge Galston in his dissenting opinion below (Pet. App. 6a, 8a), redress for any wrong, if such were charged, may be had under the Laws of the State of New York, the domicile of the Debtor-Petitioner.

‡ 11 U. S. C. 766; 66 Stat. 433.

mental requisite for the confirmation of a plan of arrangement pursuant to Chapter XI is that the plan be "for the best interests of the creditors". The creditors must be accorded primary consideration, and it is respectfully submitted that the interests of the creditors would be best served by a continuance of the proceeding in Chapter XI, rather than Chapter X. A transfer of these proceedings to Chapter X would require the appointment of a trustee who, to the extent directed by the Court, would be obliged to undertake an examination and investigation of the Debtor-Petitioner's liabilities, property, management and numerous other matters relevant to the formulation of a plan. Such measures are totally unnecessary, for the Creditors' Committee conducted an extensive examination into the affairs of the Debtor-Petitioner and there has been no charge of fraud or impropriety. To compel a transfer to Chapter X, in order to incorporate the investigatory procedures of that chapter, will only result in delay and dissipation of the assets of the Debtor-Petitioner, without deriving the benefits those procedures were designed to afford.

On the other hand, reversal of the judgment below and a continuance of the Chapter XI proceeding will permit the Debtor-Petitioner and its general, unsecured creditors to effect a settlement which would, in all probability, result in the creditors receiving 70% of their claim in cash and 30% in shares of common stock of the Debtor-Petitioner. As previously noted, this proposal received the approval of a majority of the Creditors Committee, for if a plan of arrangement may be concluded without delay and the enterprise continued with the Debtor-Petitioner free of its unsecured debts, the value of the stock received by the creditors will appreciate and substantially reduce the loss which the creditors would otherwise sustain. Such a proposal is likewise in the best interests of the stockholders of the Debtor-Petitioner, for confirmation of a plan of arrangement pursuant to Chapter XI will result in an

increase in the value of the stock of the company and the preservation of the stockholders' $2,000,000 investment in its two subsidiaries, Stineway Drug Company and Ford Hopkins Company:

(5) Despite the economic advantages of permitting the present proceedings to remain in Chapter XI, the decision below directs a transfer to Chapter X. The Debtor-Petitioner does not seek nor require reorganization.* Indeed, the decision of the Court below recognizes that the company's present corporate structure is not overly complicated.† Yet, despite the absence of a need for reorganization, the judgment below directs a transfer of the proceedings to Chapter X, apparently solely on the ground that the debtor is a corporation whose stock is publicly held, which was also the situation in the *Transvision* case.

(6) It should be noted that a transfer of the proceedings to Chapter X, with the resultant expense and delay, is not necessary in order to incorporate into the present proceedings procedural safeguards similar to those provided for in Chapter X.

Section 357 of the Bankruptcy Act‡ provides as follows:

"An arrangement within the meaning of this chapter may include—

* * * * * * *

"(7) provisions for retention of jurisdiction by the court until provisions of the arrangement, after its confirmation, have been performed; and

"(8) any other appropriate provisions not inconsistent with this chapter."

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* See opinion of Galston, D. J. (Pet. App. 6a, 8a)

† See opinion of Clark, C. J. (Pet. App. 2a)

‡ 11 U. S. C. 757; 52 Stat. 910

Protective provisions comparable to the procedures of Chapter X may therefore be included, such as the following: (1) an independent audit by auditors approved by the Securities and Exchange Commission; (2) the submission of such report to the Commission and to the Court; (3) retention of jurisdiction of the proceeding by the Court with power to make such orders as may be appropriate; and (4) distribution to the creditors and stockholders of the Commission's comments with regard to any proposed plan. Thus, the protective features of Chapter X may be combined with the speed and economy of Chapter XI so that a plan of arrangement of the general unsecured debts of the Debtor-Petitioner, which is all the Debtor-Petitioner requires, may be affected without the delay and dissipation of assets which must occur upon a transfer of these proceedings to Chapter X.

The Creditors Committee earnestly urges that the Court below in denying the Debtor-Petitioner access to Chapter XI and compelling a transfer to Chapter X, was in error. The holding of the Court below that a corporate debtor with publicly held stock may not resort to Chapter XI, when all that is sought is a composition of the debtor's unsecured obligations, has seriously affected the interests of the creditors of the Debtor-Petitioner and created a situation in which there is grave doubt as to the circumstances which require a debtor to resort to a reorganization pursuant to Chapter X. The issues involved in the present case are of vital importance and the apparent conflict between this case and the *Transcision* case should be definitively resolved by this Court.

Conclusion

For the foregoing reasons, a writ of certiorari should issue.

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